January 4, 2021

Vanessa A. Countryman
Secretary, Securities and Exchange Commission
100 F St NE
Washington, DC 20549-1090

Re: Tailored Shareholder Reports, Treatment of Annual Prospectus Updates for Existing Investors, and Improved Fee and Risk Disclosure for Mutual Funds and Exchange-Traded Funds; Fee Information in Investment Company Advertisements (File No. S7-09-20)

Secretary Countryman:

The Americans for Financial Reform Education Fund (AFREF) appreciates the opportunity to comment on the above referenced proposed rule ("the Proposal") by the Securities and Exchange Commission (the "SEC" of the "Commission") concerning the simplification and streamlining of the most useful information and fees to investors. Members of the AFR Education Fund coalition include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.[1]

The Commission's proposal to simplify the presentation of fees and expenses to improve the ability of investors to understand these critical disclosures, as well as its proposal to improve the quality of disclosures on open-ended funds, are both clearly a step in the right direction. However, we recommend that the Commission perform investor testing on these new disclosures to ensure that they are in fact the most effective way to make fund risks, returns, and expenses clear to investors. Such additional study is also necessary to make critical decisions about electronic vs paper delivery.

We also suggest that the Commission re-consider its approach in exempting funds with less than 10% of total assets invested in additional fee investment vehicles from inclusion in the acquired fund fees and expenses (AFFE) table, especially as it pertains to business development companies (BDCs) who continue to present issues related to corporate governance and whose investment advisers often have a conflict-of-interest with the BDC's shareholders.

Further study is necessary to determine the best method to effectively deliver key fund details to shareholders

[1] A list of coalition members is available at: https://ourfinancialsecurity.org/about/coalition-members/

The Commission's proposal to deliver the most relevant and concise pieces of information such as fund expenses, performance, and portfolio holdings directly to retail investors, while relegating more detailed information for fund advisers and institutional investors elsewhere online via Form N-CSR is certainly a positive development.

As prior commentors have noted, 12% of fund shareholders never review disclosures while another survey found that 63% of shareholders rarely read shareholder reports.[2] The potential to reduce annual reports from more than 100 pages to anywhere from 3 to 4 pages could assist greatly in allowing retail investors to better understand the fees they pay and the exposures they hold through their investment in a fund.

Those improvements include the simplified fee table prominently showing the percentage and also the dollars paid in fees per $10,000 in assets, allowing investors a quick, standardized comparison among different funds.

While these changes are generally positive, we note that the specific proposed changes in disclosures have not been subjected to independent investor testing overseen by Commission staff. The Commission should conduct its own investor testing of the proposed changes either before adoption of the rule or through a study after implementation of the rule. In general, the Commission should seek to incorporate pre-proposal investor into future rulemakings involving retail investor disclosures.

In addition, we believe a move to automatically enroll all investors who provide a mobile number or e-mail address in electronic delivery, as a number of industry participants have suggested, would go too far.

Aside from the fact that some investors still continue to prefer receiving fund disclosures through paper[3], additional studies have also shown that people who read items in print tend to retain information better than those who've read the same material digitally.[4] Understandably, different investors can be expected to have different preferences, and the Commission should continue to allow for investors to easily opt for their preferred method of delivery while also providing ways to switch their election with ease. We therefore oppose industry proposals to switch to a default of digital delivery.

The Commission has also suggested that it amend Rule 30e-3 for open-ended funds to allow them to send investors notices of shareholder reports that are online elsewhere instead of directly providing the report itself. This would unnecessarily add additional steps for shareholders to work through. Instead, the rules should be amended to allow for the direct

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[2] Callan, Charles. Broadridge Financial Solutions Inc. Oct 31, 2018. https://www.sec.gov/comments/s7-12-18/s71218-4595392-176342.pdf
[3] Roper, Barbara. Consumer Federation of America. Dec 15, 2020. https://www.sec.gov/comments/s7-09-20/s70920-8144542-226675.pdf
[4] Ackerman, Rakefet and Goldsmith, Morris. National Center for Biotechnology Information. Mar 2011. https://pubmed.ncbi.nlm.nih.gov/21443378/

dissemination of a simple summary of the report with the web portal offering additional details for fund advisers and institutional investors.

Additional transparency is necessary related to transaction costs and research

Shareholders would also benefit greatly if the Commission were to expand requirements for fund managers in their annual reports to disclose to institutional investors the costs of third-party research and transaction costs, which the shareholders also bear. This could be done via an online portal.

In recent years, a number of pension funds have moved to unbundle fees related to recordkeeping, trust services, and legal advisors, and as a result improved their quality or service and/or pushed their costs lower.[5]

Additional information on trading and research expenses could also help fund managers benchmark the cost of research and trading (which include a combination of commissions and the bid/ask spread) to others across the industry, potentially helping to negotiate better terms for themselves as well. We thus recommend that the Commission require full disclosure of research and transaction costs to institutional investors.

Prioritizing disclosures of most pertinent principal risks are helpful but the actual usefulness is questionable

The Commission's proposal to require a disclosure of the varying principal risks in a fund by order of priority could be a helpful change. This is especially true given that many investors find the existing disclosures to be too long and unclear. Replacing a potentially long list of generic risks with a shorter, more focused list of what the fund judged as the most critical risks would be useful in rendering disclosures easier to comprehend.

The Commission proposes to classify any loss that the fund managers judge as reasonably likely to place more than 10% of the fund's assets at risk as a principal risk requiring disclosure. This change provides useful focus to risk disclosure and can potentially shine a light on certain risky activities a fund engages in such as purchasing derivatives, investing in foreign securities without a currency hedge, and making investments that are highly exposed to movements in interest rates.

But the Commission should not assume that this change, if made, proposal will be a cure-all for risk disclosure to investors. After all, a manager may not identify certain risks until it is too late to address them. This was true in the case of Third Avenue Management in 2015 and the

[5] Manganaro, John. Plan Sponsor. "Partial Bundling Overtakes Full Bundling for Retirement Plan Services". Apr 10, 2019. https://www.plansponsor.com/partial-bundling-overtakes-full-bundling-retirement-plan-services/

illiquidity risk of many of its high yield bonds suddenly forcing the fund to halt redemptions and eventually shut down.[6]

Different managers may also hold different opinions as to the most pressing principal risks in a fund. One fund may find that currency risks could be a potential source of risk while another fund with similar holdings may instead worry more about an unexpected sharp move in interest rates.

The 10% total asset threshold for which an AFFE exemption would apply is arbitrary and would harm investors

The Commission should drop its proposal to allow mutual funds who have less than 10% of their total assets in additional "acquired funds" to exempt listing these additional expenses from the acquired fund fees and expenses (AFFE) table.

Such a 10% number is an arbitrary threshold that can be easily gamed by market participants. More importantly, the solution ignores significant issues with business development companies (BDCs), who would be a major beneficiary of this change. These issues include corporate governance and the conflicts-of-interest BDC advisers face due to incentives to maximize their fees instead of acting in the best interest of their shareholders.

Already, Commissioner Allison Herren Lee has expressed a concern that a mutual fund with 9% of its total assets invested in funds with high fees would be exempt from including those fees in the AFFE table, instead allowing them to be footnoted, while another fund with over 10% in low-fee funds would be subject to including them, giving the initial appearance of higher fees for the latter.[7]

Industry groups representing BDCs have been advocating for pushing acquired fund expenses to a footnote in order to attract interest from mutual funds sensitive to showing higher expense ratios as well as inclusion in various indexes. Industry advocates argue that costs BDCs charge for fund management are not properly characterized as "fees" because they include the costs associated with sourcing private company investments and operating the BDC.[8]

We strongly disagree with this claim. BDCs often perform poorly over the longer-term because of their high operating costs and fees.[9] While the argument is technically correct that BDC

[6] McLaughlin, Tim et al. Reuters. "Hidden in plain sight: Big risks at failed Third Avenue fund were clear to some". Dec 23, 2015. https://www.reuters.com/article/us-funds-thirdavenue-junk-insight/hidden-in-plain-sight-big-risks-at-failed-third-avenue-fund-were-clear-to-some-idUSKBN0U627V20151223
[7] Statement on Proposed Summary Shareholder Report. Aug 5, 2020. https://www.sec.gov/news/public-statement/lee-open-meeting-summary-shareholder-report-2020-08-05
[8] Small Business Investor Alliance. Nov 14, 2019. https://www.sbia.org/news/re-application-of-acquired-fund-fees-and-expenses-affe-rule-to-business-development-companies-bdcs/
[9] Chambers, Donald. Seeking Alpha. "Business Development Companies: A Primer With 2 Warnings". Oct 8, 2020. https://seekingalpha.com/article/4378145-business-development-companies-primer-2-warnings

advisers do not directly bill investors all the fees that are listed on the AFFE table and their higher fees stem from including operating costs, while other assets often do not, the higher fees associated with BDCs still effectively come out of the pockets of investors in the form of a lower net asset value (NAV). That NAV is critical to determining the price a publicly traded BDC trades for in the secondary market. Investors are interested in the bottom-line cost to them, not technical arguments about the classification about the classification of expenses.

It is therefore critical that funds who purchase BDCs are accountable and face incentives to be sensitive to the wide range of operating costs and fees across different BDC advisers.

An example of the sometimes startling level of BDC fees can be seen in the following table below:

Annual expenses (as a percentage of net assets attributable to common stock):	
Management fees (7)	4.66%
Incentive fees payable under Investment Advisory Agreement (20% of realized capital gains and 20% of pre-incentive fee net investment income) (8)	1.82%
Total advisory fees	6.48%
Total interest expenses (9)	4.56%
Other expenses (10)	1.27%
Total annual expenses (8)(10)(11)	12.31%
Dividends on Preferred Stock(12)	2.17%
Total annual expenses after dividends on Preferred Stock (13)	14.48%

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The focus on BDC fees is especially pertinent given the Commission's decision in April to allow BDCs to take on portfolio leverage of up to 200%.[11]

Even if we were to ignore a majority of the expenses, expenses that total 12.31% in the table above, the management fees alone are quite hefty. Investment adviser Prospect Capital Management L.P. is charging a management fee of 2% of the fund's gross assets. The adviser's use of additional leverage however results in a higher gross asset base which fees are calculated from. Prospect effectively charges over twice that listed rate, coming out to a management fee of 4.66% of net assets.

An easy comparison of total BDC fees is also important to highlight any potential irregularities. Some advisers have been found to fraudulently pass off expenses to investors and inflate asset values in order to collect higher fees. Fifth Street Management LLC on December 2018 settled with the SEC over improperly passing its rent, overhead, and compensation onto investors while also overvaluing the value of two of its companies in 2014 and 2015.[12]

Given all of these issues, we advise the Commission not to proceed with allowing funds with less than 10% of their assets in acquired funds to relegate details of their high fee investments

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[10] Prospect Capital Corporation. Form 10-Q. Nov 9, 2020. https://www.sec.gov/Archives/edgar/data/1287032/000128703220000390/psec10-qq12021.htm

[11] DeCapo, Thomas et. al. Skadden, Arps, Slate, Meagher & Flom LLP. "SEC Relief Permits BDCs to Incur Additional Leverage". Apr 13, 2020. https://www.skadden.com/insights/publications/2020/04/sec-relief-permits-bdcs-to-incur-additional

[12] SEC Administrative Proceeding File No 3-18909 against Fifth Street Management LLC. Dec 3, 2018. https://www.sec.gov/enforce/33-10581-s

to a footnote. Rather, the Commission should require full disclosure of expenses from acquired funds, while also permitting funds invested in other acquired funds to include a footnote explaining in plain English the ways in which AFFE expenses do and do not differ from traditional fund fees.

Conclusion

We recommend the Commission conduct additional studies to better determine how to best deliver shareholder proposals and disclosures to shareholders either electronically, on paper, or a combination of both. It is important that with the limited attention spans of investors, such documents are optimized using our modern advances to concisely deliver the most pertinent information in a simple and easy to understand manner.

We would also like to see the scope of disclosures expanded to include transaction costs and research as that additional level of transparency can offer insight into those practices and help the investment fund benchmark the level of fees they are paying against others in the industry.

The inclusion of principal risks in order of priority can be helpful, but fraught with differences in opinion across investment managers and actual surprise developments in the market may suddenly elevate other risks such as currency, interest rate, liquidity, etc.

Finally, we strongly oppose permitting who hold less than 10% of their total assets in other acquired funds to remove disclosures of these funds to investors from core disclosures such as the AFFE table. Until the incentives change for BDCs to abide by more shareholder friendly practices rather than collecting large amounts of fees that eat into returns, those amounts should still be reflected on the AFFE table.

If the returns of BDCs are truly as compelling as industry advocates say they are, even after the different fees and operating expenses, surely investors would continue to purchase those names in this low interest-rate environment even if fund expenses were fully transparent.

We appreciate your consideration of this important matter. For further discussion, please contact Andrew Park at andrew@ourfinancialsecurity.org.

Sincerely,

Americans for Financial Reform Education Fund